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CHARLES ELMORE

Supreme Court of the United States

TERM, 1951

No. 694

In the Matter of

BELT MODES, INC.,

Bankrupt.

WILLIAM J. HENRY, Trustee in Bankruptcy,

Petitioner,

—against—

HELEN HOLLANDER, HARRY SHIMOFF, ROSE RENO, MORRIS DRABNER, EVA YUTKOFSKY, DAVID WISOTSKY, MILDRED L. FRANCES, DOROTHY QUITTNER, THELMA LOPEZ, SAM WEINBERG, GLORIA ANNIE JOSEPH, SAM SIEGAL, LEO KNAPHEIS and MAX KANER,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ALLEN MURRAY MYERS
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable Chief Justice and the Associate Justices of the Supreme Court of the United States:

WILLIAM J. HENRY respectfully petitions that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this cause on the 29th day of January, 1951, petition for rehearing having been denied on the 19th day of February, 1951.

A

Jurisdiction

The jurisdiction of this Court is invoked under Title 11, United States Code, Section 47 (c). The date of the judgment of the United States Court of Appeals for the Second Circuit sought to be reviewed is January 29th, 1951. The date that the petition for a rehearing was denied is February 19th, 1951.

B

Summary Statement of Matter Involved

Petitioner is the Trustee in bankruptcy of Belt Modes, Inc. (hereinafter referred to as Belt Modes), which was adjudicated a Bankrupt in the United States District Court for the Southern District of New York.

Respondents are employees of another corporation known as Danin, Inc. (hereinafter referred to as Danin).

Danin, Inc. was incorporated on January 22nd, 1946; Belt Modes, Inc. was incorporated on June 17th, 1946 (R. 164).

Daniel Rubin (hereinafter referred to as Rubin) is the sole stockholder of both Danin and Belt Modes (R. 12, 60, 61).

Prior to the incorporation of Belt Modes, Inc., Rubin manufactured ladies' belts as an individual entrepreneur, doing business under the trade name of "Belt Modes" (R. 97).

In the early part of 1946 Rubin began to manufacture children's and ladies' handbags. To manufacture belts, he had to sign a contract with the Beltmakers' Union and to manufacture pocketbooks, a contract had to be signed with

the Pocketbook Workers' Union (R. 12, 13). Rather than combine both operations, Rubin organized Danin, Inc. for the purpose of manufacturing pocketbooks.

The said corporation received $1,000.00 from Rubin and the capital stock account was credited for that amount. During the year 1946 he also advanced funds in cash and machinery to Danin so that the corporation was indebted to Rubin in an amount of $18,654.17. Rubin's relation to Danin was the normal and usual relationship between stockholder and corporation.

In the early part of 1946, at the insistence of the Pocketbook Workers' Union, Rubin, on behalf of Danin, signed a union contract with them, covering the employees of Danin (R. 12).

Danin was a separate entity (R. 48, 49). It rented its own premises (R. 15, 31, fol. 93), hired its own help, owned its own fixtures, machinery and equipment, had its own complete set of books and records, stationery, bank account, issued its own checks, paid its own taxes, issued financial statements, purchased insurance for itself, and participated in other normal business procedures (Trustee's Exhibit 21, R. 75) (Trustee's Exhibits 1-20, R. 28, 29, 30, 31, 34, 41, 50, 51).

About five months after the incorporation of Danin, Rubin incorporated Belt Modes. Belt Modes was a separate entity. It operated from its own premises, had its own complete set of books (R. 22), hired its own help (R. 27), had its own bank account, filed its own tax returns (R. 48), and issued its own financial statements (R. 48). Neither Belt Modes, Danin, Rubin, Danin's creditors, nor Belt Modes' creditors ever claimed any connection between Danin and Belt Modes. All of the books, records, financial statements and tax returns of Belt Modes and Danin indicated no relationship between the two (R. 48, 49, 53, 95,

96). While Danin's employees and other creditors knew of the existence of Belt Modes, the latter's creditors never knew of the existence of Danin.

Belt Modes only manufactured belts. Pocketbooks were manufactured for it by several contractors, of which Danin was one (R. 61, fol. 181, Trustee's Exhibit 21, R. 75, R. 158).

The transactions between Danin and the Bankrupt followed the usual pattern found in a jobber-contractor relationship. At the end of every month Danin rendered a bill to Belt Modes. This bill was entered on the Danin books as a debit to accounts receivable and a credit to sales and was entered on the Belt Modes books as a debit to "purchases—contractors, labor and materials" and a credit to contractors payable (Trustee's Exhibit 21, R. 75; Trustee's Exhibit 14, R. 41).

All of the payrolls of Danin were paid out of Danin's bank account (Trustee's Exhibit 21, R. 75).

In or about the middle of 1947 Danin moved into the same premises occupied by Belt Modes but continued to operate separately as it had done previously (R. 21).

An involuntary petition in bankruptcy was filed against Belt Modes on May 13th, 1948 and Belt Modes was subsequently adjudicated as such. Danin is still in existence, has assets, is not a bankrupt and is not involved in this bankruptcy proceeding (R. 21).

In spite of the fact that the claimants herein were the employees of Danin, they filed wage claims against the estate of the Bankrupt (R. 6). The Trustee objected to such claims on the grounds that the Bankrupt was in no way obligated to said claimants in that the claimants were never employed by the Bankrupt and never rendered any work, labor or services for the Bankrupt (R. 10).

The Bankrupt paid Danin in full for every pocketbook it purchased from Danin. The purchase price covered all

of Danin's costs, including the cost of labor, plus 15% (Trustee's Exhibit 14, R. 41, 45). If the Bankrupt were to pay Danin's wage claims in addition thereto, it would be paying twice for the same labor costs.

None of Danin's assets are in the hands of the Bankrupt nor of the Trustee, and the Trustee has no claim to the said assets, so that the payment of Danin's obligations would come solely out of the Bankrupt's assets.

The claimants herein have not shown that they were not or could not have been paid out of the assets of Danin; that they have commenced any legal proceedings against Danin or that they have exhausted their legal remedies against Danin before filing claims against the Bankrupt.

The claimants' ground for demanding payment from the Bankrupt instead of from their employer, Danin, was that Rubin was the sole stockholder of both corporations, had complete control over both, and they could therefor claim payment from either or both.

C

Proceedings in the Courts Below

The Referee allowed the claims in question. (See Referee's Findings and Conclusions, R. 77.)

The Trustee petitioned for a review of the Referee's decision which petition was argued before Hon. Murray Hulbert, a Judge of the District Court on the 18th day of May, 1949. Judge Hulbert held, among other things, in an opinion handed down on June 16th, 1949, that:

> "In the present case, however, the Referee has 'pierced' the corporate veil not to prevent the perpetration of a fraud on the wage claimants, for they were parties

> through their Union Contract to the corporate set-up being as it was. Rather it appears that a fraud would be perpetrated on the creditors of the Bankrupt who became such without the knowledge of the existence of Danin. Furthermore, if the wage claims of the employees of Danin are upheld as claims against the Bankrupt, then the Bankrupt would also be liable for all other debts of Danin, including tax claims, workmen's compensation, and negligence liability. Before such a result should be allowed there must be further findings to justify the setting aside of the corporate entity • • • "

and the matter was remanded to the Referee for further proceedings (R. 84).

As a result of this decision new hearings were held by the Referee. The evidence brought out at the second hearing was substantially the same as that produced at the first hearing. The Referee however adhered to his original decision (R. 123).

The Trustee again petitioned for a review of the Referee's decision. The second petition was heard by Hon. Irving R. Kaufman, a Judge of the District Court, who again reversed the order of the Referee and disallowed the said claims (R. 133), stating:

> "There seems to be no question about the fact that Danin, Inc. and Belt-Modes, Inc., were two separate corporations which were organized at different times for two separate and distinct purposes. It is admitted that no fraud or illegality was perpetrated on the claimants in this case, but that the corporate set-up was used specifically to prevent a labor jurisdictional dispute. If these claims were to be allowed, an injus-

tice would be done to the creditors of the Bankrupt who extended credit to the Bankrupt and had no way of knowing of the existence of these claimants as creditors."

The claimants appealed to the United States Court of Appeals for the Second Circuit.

The Court of Appeals reversed the District Court's decision (See opinion R. 146). It did not reverse squarely on the law, but evolved a new theory of the facts to sustain its position.

The Court's theory of the facts was that the Bankrupt either hired the claimants directly, thus making them its own employees (R. 150) or that the Bankrupt agreed to "*secure* the wages of the pocketbook workers * * *" (R. 151).

The Court's theory of the law was that the corporate entity of Danin could be ignored because "the stockholder did not use its control over the corporation in the normal and usual manner, but used the corporation as an agent for the transaction of the stockholder's business" (R. 149).

Trustee's Twenty-one Exhibits Not Before the Court of Appeals

After the rendering of the Court of Appeals' decision, it was discovered that all of the Trustee's exhibits, twenty-one in number, which constituted the Trustee's entire case, were not before the Court (R. 155). For this reason a petition for a rehearing was made to give the Court an opportunity to reconsider the case upon the complete record. This petition was denied.

Petitioner by this petition is therefor seeking to review the judgment of the said Court of Appeals.

D

Summary of Argument

Petitioner's argument can best be summarized as follows:

First: It was against the weight of the credible evidence to have found that,

a) the Bankrupt had hired Danin's employees directly; or that

b) the Bankrupt had agreed to *secure* their wages.

Second:

a) A finding that there was a direct employment contract with the Bankrupt would presume that the Bankrupt had falsified all Federal and State employment tax returns, financial statements, books, records, and income tax returns, by failing to reveal the existence of said employees and to pay Withholding, Social Security and Unemployment Taxes on their wages.

b) A finding that there was an agreement to *secure* the wages of Danin's employees would have been void under Section 31 (2) of the New York State Personal Property Law,* because it was not in writing.

Third: The corporate entity of Danin should not have been ignored.

Fourth: If the corporate entity of Danin should have been ignored, then the just thing to have done was to have held its stockholder, Rubin, responsible to Danin's employees and not the Bankrupt.

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* See footnote, page 17 *infra*, for text.

Fifth: If the disputed claims were allowed against the Bankrupt, they should not have been accorded priority over the claims of other general unsecured creditors of the Bankrupt.

Petitioner's points will be:

1. That the Court of Appeals erred in finding facts not found in the Court below.

2. That the corporate entity of Danin should not have been disregarded because it was not formed nor used to subvert justice, perpetrate a fraud or do wrong.

3. That the corporate entity should not be disregarded when the rights of innocent creditors have intervened as in the present case.

4. That before the claimants should have been permitted to go beyond the corporate entity of Danin they should have shown that they had exhausted their legal remedies against it.

5. That when ignoring the corporate entity of Danin, Rubin, its sole stockholder, should have been held liable for its corporate obligations and not the creditors of the Bankrupt.

6. That the ends of justice and of equity would be served only if Danin or Rubin were held liable for Danin's obligations to its employees; that it would be unjust and inequitable to hold the creditors of Belt Modes liable therefor.

7. That an agreement making a manufacturer responsible for the payment of wages by a contractor does not entitle the employees of the contractor to priority in the bankruptcy of the manufacturer.

E

The Conflicting Interests

The various conflicting interests to be resolved upon this appeal, are as follows:

The interests of:

1. *The Creditors of Belt Modes, Inc.*—They are innocent bystanders to all of the transactions involved. They knew nothing of the existence of Danin, of Danin's obligations, and of the Pocketbook Workers' Union contract with Danin. They did not benefit from the Danin-Rubin-Belt Modes relationship. If the Bankrupt is required to pay Danin's wage claims, it will come out of their pockets.

2. *Danin's Wage Claimants*—They were hired by, worked for and were always paid by Danin. They knew at all times of the existence of the Bankrupt and of the relationship between Rubin, the Bankrupt and Danin. It was at their insistence that their Union signed a contract with Danin and not with the Bankrupt. All of their negotiations were always with Danin.

3. *Rubin*—He is the sole stockholder of both Danin and Belt Modes, the "flesh and bones" behind both corporations. If, in the interests of justice, it is required that such legal fiction as the corporate entity be swept aside, it is Rubin and Rubin alone upon whom the corporate obligations should fall, and not upon the innocent creditors of Belt Modes.

While it is true that the Courts will not permit the corporate cloak to be used as a means of perpetrating a

wrong, it is likewise true that the Courts will not hurt innocent third parties in an attempt to right that wrong.

In the case at bar the Court of Appeals attempted to help Danin's employees by allowing their claims against the estate of Belt Modes. But in so doing it perpetrated an injustice upon creditors of Belt Modes.

F

Importance of the Issues Involved

While the corporate entity has many times been ignored in order to prevent the stockholders from using it to perpetrate an injustice, this is the first time that in doing so a Court has held liable the innocent creditors of an insolvent corporation for the debts of another, a solvent corporation, because of the actions of the sole stockholder of both corporations; the said creditors being without any knowledge of the stockholder's actions or of the existence of this other corporation.

The corporate device for limiting personal liability is of such general use, and so universally relied upon that the public should know exactly when such corporate entity will be ignored and how far the boundaries of liability will be extended.

There have been several decisions on the subject, but none have stretched the doctrine so far as in the instant case, where the Court went from the corporation, to the stockholder, to another corporation owned by the same stockholder, to the creditors of the latter corporation, in their search to attach liability.

It should be borne in mind that in the case at bar the parties charged with liability were guilty of no wrongdoing and were in no way responsible for any harm to the claimants; nor were they unjustly enriched by the corporate arrangements being what they were.

G

Petitioner's Specification of Errors

The Court of Appeals erred in the following respects:

1. In finding that the Bankrupt had made an agreement either,

a) hiring claimants directly as its own employees; or

b) to *secure* the payments of their wages, in spite of the prohibition of Section 31(2) of the New York State Personal Property Law.*

2. In holding that the corporate entity of Danin should be ignored, and that the Bankrupt be held liable to the claimants even though it would adversely affect the creditors of the Bankrupt.

3. In failing to hold that if the corporate entity of Danin were ignored, Rubin, its sole stockholder was to be held liable and not the Bankrupt.

4. In allowing priority status to the claims in question.

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* See footnote, page 17 *infra*, for text.

H

Questions Presented

There are serious questions of law and fact involved in this appeal, to wit:

1. Does Federal or State Law govern the situation?

2. Was the Court justified in disregarding the corporate entity of Danin?

3. Was the Court justified in treating the wage claimants of Danin as the wage claimants of the Bankrupt?

4. Since Rubin was the sole stockholder of Danin, upon removal of the "corporate veil", would not Rubin be the party behind the "corporate veil" to be charged with Danin's obligations to its employees rather than the Bankrupt?

5. Since the corporate entity will be ignored only to do justice or to right a grievous wrong proximately caused by the use of such corporate entity, what justification can there be for foisting this obligation upon the creditors of the Bankrupt who had nothing to do with the creation or use of such corporate device?

6. Should not the fact that Belt Modes was insolvent, thus making its creditors the real parties in interest, have militated against ignoring the corporate entity of Danin and holding Belt Modes responsible for its obligations?

   a) Do not the creditors of Belt Modes stand in the position of innocent third parties?

7. Since the Court has to decide between two conflicting equities, to wit, the creditors of Danin and the creditors of Belt Modes, should not the equity in favor of the credi-

tors of Belt Modes prevail because Danin's wage claimants participated in the organization of Danin, and Danin was organized specifically for their benefit, whereas the creditors of Belt Modes knew nothing of the existence of Danin and never benefited from its existence?

a) Would it not be a fraud upon the creditors of the Bankrupt to permit the Trustee to pay the wage claims of Danin, when all of the financial statements and records of both corporations never reflected such an obligation, and the creditors have extended credit upon reliance that no such obligation existed?

8. Should the Court have ignored the corporate entity without proof that the claimants were directly hurt thereby; that if not for the use of the corporate device their wages would have been paid?

9. Was it not reversible error to have decided this case on only half the record?

10. Were the employees of Danin entitled to priority under Section 64a (2)* of the Bankruptcy Act on a par with the employees of Belt Modes?

11. Was the alleged agreement to "secure" Danin's employees void under Section 31 (2) of the Personal Property Law of the State of New York?**

---

* Section 64a (2) of the Bankruptcy Act (United States Code, Title 11, Chap. 7, Sec. 104a (2)) provides,

"a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt;"

** See footnote, page 17 *infra*, for text.

I

ARGUMENT

POINT I

The Court of Appeals erred in finding facts not found in the Court below.

The opinion of the Court of Appeals appears at page 146 of the Record. For the sake of brevity it is not being repeated here.

The Court of Appeals erred in its interpretations of the facts and the law. From the opinion it would appear that the Court of Appeals, not being able to justify a reversal squarely on the law, strained itself to evolve a new theory of the facts.

A comparison of the facts as stated in the opinion of the Court of Appeals with the facts as stated in the opinions of both Judges of the District Court (R. 84, 133) and with the Findings of the Referee (R. 77, 123) would lead one to believe that they were adjudicating different cases.

In order to justify its decision the Court of Appeals extended itself to find that Belt Modes had made a separate contract with Danin's employees either to "secure" their wages (R. 151, fol. 153) or to employ them directly (R. 150). Such a finding was not made either by the Referee in the Court below, after both hearings, or by either of the Judges of the District Court, both of whom reversed the Referee. Nor was the existence of such an agreement claimed by the respondents in the Courts below. The documentary evidence as contained in the books and records of both corporations negated any such agreement.

The alleged agreement inferred by the Court of Appeals was based on an alleged conversation which took place at or about the time that Danin was organized, which was January 22nd, 1946. The Bankrupt did not come into existence until June 17th, 1946, five months later.

When Gallack, on behalf of the Pocketbook Workers' Union allegedly discussed his relationship with Belt Modes, Belt Modes was not yet incorporated. Belt Modes was Rubin's trade name (R. 97, fol. 290). The same holds true for the testimony of Sol Pitkin (R. 111, fol. 333). They dealt with "Belt Modes as an individual" and "before it was incorporated."

The Court seemed to miss that point entirely. It assumed that Rubin spoke on behalf of the corporation, the Bankrupt herein, when as a matter of fact the Bankrupt was not yet in existence at the time, and he spoke on behalf of himself. If any inference was to be made, it should have been that Rubin had pledged his personal credit and not that of a non-existent corporation (R. 164, Par. 20).

The Court of Appeals based its findings upon an inference. It stated that Rubin,

> "*must have* so intended ('to make the Bankrupt liable') because not to do so would have left the claimants with an employer destitute or substantially destitute, of any power to perform its engagement" (R. 149, fol. 151).

This inference was not justified. It was neither alleged nor proven that Danin was destitute (R. 161). No such finding was made either by the Referee or the Judges of the District Court.

The Court of Appeals also overlooked the fact that in accordance with Section 31 (2) of the Personal Property Law of the State of New York,* an oral agreement or promise by Belt Modes to "secure" the payment of Danin's obligations to its employees would be void.

Furthermore the following facts indicate that no such agreement was ever made:

1) Said agreement was never reduced to writing either by Belt Modes or the Union.

2) Neither the books and records of Danin nor of Belt Modes reflected any such agreement.

3) No written or unbiased evidence of any such agreement is to be found in the record.

4) Claimants never stated that they relied upon any such agreement and offered no such proof at the first hearing.**

---

* Section 31(2), New York Personal Property Law:

Agreements required to be in writing.

Every agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent, if such agreement, promise or undertaking;

(2) Is a special promise to answer for the debt, default or miscarriage of another person.

** In the Court of Appeals claimants offered the following argument to sustain their position:

"It is our submission that Judge Hulbert and Judge Kaufman erred in holding that the evidence does not sustain the Referee's Finding that Danin 'was merely a department or division' of Belt Modes and 'was not intended or conducted as a corporation engaged in business for profit.' It is also our submission that the learned judges erred in holding, upon the basis of certain New York decisions, that corporate entities will be disregarded in a bankruptcy proceeding only where 'the purpose of using the subsidiary corporation as a cloak was to commit a fraud or other illegal purpose.'"

5) A direct employment agreement would infer that Belt Modes had violated several statutes in failing to pay Social Security, Withholding and Unemployment Insurance Taxes for the employees in question, in failing to cover them with Workmen's Compensation, and in failing to report their income on W-2 forms to the Collector of Internal Revenue.

6) It would imply that the books, records and financial statements of both Danin and Rubin were false, because they failed to disclose and record Belt Modes' liability to said employees.

It is respectfully submitted that had the Court examined the books and records as set forth in the Trustee's twenty-one exhibits it most likely would not have inferred that such an agreement had been made.

POINT II

The corporate entity of Danin should not have been disregarded because it was not formed nor used to subvert justice, perpetrate a fraud or do wrong.

Danin was organized to avoid a jurisdictional union dispute and kept its operations separate and apart from those of Belt Modes. This was a legal, honest and beneficial purpose. It was known to Danin's employees and had their consent. There was no ground therefore for disregarding the corporate entity.

When should the corporate entity be ignored?

Professor Maurice Wormser, in his treatise on the subject sets forth the following circumstances under which a corporate entity should be ignored.

> "What general rule, if any, can be laid down? The nearest approximation to generalization which the present state of the authorities would warrant is this: When the conception of corporate entity is employed to defraud creditors, to evade an existing obligation, to circumvent a statute, to achieve or perpetuate monopoly, or to protect knavery or crime, the courts will draw aside the web of entity, will regard the corporate company as an association of live, up and doing men and women shareholders, and will do justice between real persons." *Wormser, Disregard of the Corporate Fiction,* p. 84.

The corporate entity should not be lightly ignored. To quote Judge Learned Hand, in *Kingston Dry Dock Co.* v. *Lake Champlain Transp. Co.,* 31 Fed. (2d) 265, 267:

> "The (claimants) being dissatisfied with the credit of (one corporation), with which (they) dealt now seek to involve (another corporation) on the notion that the whole enterprise was single in all its aspects. So long as the law allows associated groups to maintain an independent unity, its sanction is not so easily evaded, and persons dealing with either do so upon the faith of the undertaking of that one which they may select."

The Court of Appeals for the Fifth Circuit in the case of *Commerce Trust Company* v. *Woodbury,* 77 F. (2d) 478 (C. A. 5th, 1935), cert. den. 296 U. S. 614, stated:

> "The Courts will ignore the fiction of corporate entity only with caution, and when the circumstances justify it and when it is used as a subterfuge to defeat public convenience, justify wrong or perpetrate a fraud."

In the case of *Lowendahl* v. *Baltimore and Ohio Railroad Company* (247 App. Div. 144, aff'd 272 N. Y. 360), the Court set forth three elements which must be proved before it will disregard the separate corporate entity and hold the stockholder liable. These elements were stated as follows:

> "(1) Control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had *at the time* no separate mind, will or existence of its own; and
>
> "(2) Such control must have been used by the defendants to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights; and
>
> "(3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of."

It has also been held that the stockholder will be held liable for the act of the corporation when he did not use his control of the corporation in the *"normal and usual manner"* but used the corporation as an agent for the transaction of part of the stockholder's business (***Rapid Transit Subway Construction Company*** v. ***The City of New York,*** 259 N. Y. 472, 491).

The New York Court of Appeals in the *Rapid Transit* case, *supra,* cited two decisions of the Supreme Court which held to the same doctrine, to wit, *Chicago, Milwaukee and St. Paul Railway Company* v. *Minneapolis Civic and*

Commerce Association, 247 U. S. 490, 500, 501; and *Davis* v. *Alexander,* 269 U. S. 114, 117. The Court of Appeals in the instant case cited the *Rapid Transit* case with approval.

Should the Corporate Entity Have Been Ignored in the Case at Bar?

However, the case at bar does not come within the category of cases where control was not used in the normal and usual manner. The following two cases are illustrative of the point:

In *Berkey* v. *Third Avenue Railway Co.,* 244 N. Y. 84, the plaintiff was injured while riding on a car of the 42nd Street Ry. Co., and recognizing the inability of that company to pay a judgment, sued the Third Avenue Railway Co., of which the 42nd Street Railway Co. was a subsidiary, claiming that the corporate entity of the servient corporation should be disregarded, since it was the *alter ego* of the parent corporation, which owned its entire stock.

In his learned opinion, Cardozo, *Ch. J.,* pointed out (244 N. Y. at p. 87) that: "substantially all the stock of that company is owned by the Third Avenue Railway Co." and the president of the Third Avenue Railway Co., in making its report to the stockholders of the Third Avenue Railway Co. exhibited the consolidated income of both companies in one statement (*Ibid,* at p. 88):

"The members of the two boards of directors were nearly, though not quite the same. Each road had the same executive officers, *i.e.* the same president, treasurer, general manager, paymaster and counsel. The parent has made loans to the subsidiary from time to time, sometimes for construction and sometimes for operating expenses."

"All the cars, wherever used, are marked Third Avenue System" (*Ibid,* p. 89).

"The cars when new ones become necessary, are bought by the defendant, and then leased to the subsidiaries, including of course the 42nd Street Railway Co., for a daily rental which is paid."

The New York State Court of Appeals held that, in spite of these facts, the 42nd Street Railway Co. was not a mere dummy or *alter ego* of the parent corporation, and in spite of the use of one company's assets by the other and the general interchangeable names that were used, the parent company could not be held legally liable for the torts of the subsidiary. Cardozo, *Ch. J.*, said (*Ibid,* at p. 95):

"In such circumstances, we thwart the public policy of the State instead of defending or upholding it, when we ignore the separation between subsidiary and parent, and treat the two as one."

In the case of *In re Watertown Paper Company,* 169 Fed. 252 (C. C. A. 2nd), after the organization of a paper company, its stockholders caused the organization of a pulp company, with funds advanced by the paper company, but for the account of its stockholders to whom the advancements were charged. The paper company itself owned no stock of the pulp company. While the two corporations mingled their affairs, *e.g.,* the paper company purchased its pulp, supplies, etc. from the pulp company, and the stockholders in control apparently regarded the two corporations merely as different departments of one general business, yet separate corporate organizations were kept up, distinct sets of corporate books were maintained, and each conducted its own business in its own name. The Court held that the affairs of the two corporations were not so conducted as to make one company a mere dummy or instrumentality of the other and that the pulp company could enforce its claim against the bankrupt estate of the paper company.

Noyes, Circuit Judge held,

"Now, it is an elementary and fundamental principle of corporation law that a corporation is an entity separate and distinct from its stockholders and from other corporations with which it may be connected. The fact that the stockholders of two separately chartered corporations are identical, that one owns shares in another, that they have material dealings, will not as a general rule merge them into one corporation, or prevent the enforcement against the insolvent estate of the one, of an otherwise valid claim of the other. As said by the Supreme Court of Arkansas in *Lange* v. *Barke,* 69 Ark. 85, 88, 61 S. W. 165, in holding, in a case where two corporations were practically controlled by the same stockholders and had had intimate business relations, including the employment of the same bookkeeper, that a claim of one corporation would be enforced against the insolvent estate of the other:

'A corporation is an artificial being, separate and distinct from its agents, officers, and stockholders. Its dealings with another corporation, although it may be composed in part of persons who own a majority of the stock in each company, and may be managed by the same officers, if they be in good faith and free from fraud, stand upon the same basis, and effect it and the other corporation in the same manner and to the same extent, that they would if each had been composed of different stockholders and controlled by different officers' (*Ibid,* at pp. 255-256).

"Neither the Paper Company nor the Pulp Company own any of the other's shares, and in no sense can it be said that the Paper Company organized the Pulp Company as a department of its business" (*Ibid,* at p. 257).

The opinion of Hon. Irving R. Kaufman, one of the District Judges in the instant case (R. 139) also considered the question as to whether the corporate entity should have been ignored in the case at bar in accordance with the rule as set forth in the *Rapid Transit* case, *supra*. The Court felt that it should not and set forth its reasoning as follows:

> "The 'corporate veil' may be pierced in cases where the corporation concerned in the suit is a front or mere conduit for carrying on the business of a parent corporation, but even here the test is whether the purpose of using the subsidiary corporation as a cloak was to commit a fraud or illegal purpose. *Jenkins* v. *Moyse*, 254 N. Y. 319 (1930). The New York courts are very reluctant to disregard the corporate entity. See, *e.g.*, *Rapid Transit Subway Construction Co.* v. *City of New York*, 259 N. Y. 472 (1932); *Berkey* v. *Third Avenue Ry. Co.*, 244 N. Y. 84 (1926); *Lowendahl* v. *Baltimore & Ohio R. Co.*, 287 N. Y. S. 62, 247 App. Div. 144 (1st Dept., 1936), aff'd 272 N. Y. 360 (1936).
>
> "The law of New York has been set forth in two recent decisions whose fact situations are relevant to the present case. In *Oceanic Insul-Lite Corp.* v. *Sullivan Dry D. & R. Corp.*, 77 N. Y. S. 2d 498 (1947), Justice Froessel stated that 'corporate entity will not ordinarily be disregarded, except where the corporate form has been used as an instrumentality of wrong and injustice' (p. 500). In refusing to allow as a set off, against a claim by plaintiff in the action, a counter-claim by defendant against a corporation owned, operated and controlled by the same stockholders as those owning, operating and controlling plaintiff, the court said: 'What we have here is simply the creation of two

corporations by the same interests for the purpose of keeping separate and apart different operations in connection with the repair of ships, and there is no proof that the corporate form was used as a cloak to cover for *fraud or illegality*' (p. 501). (Emphasis added.)

"Even more in point is the decision in *Gruenebaum* v. *Lissauer,* 57 N. Y. S. 2d 137, 185 Misc. 718 (1945), aff'd 61 N. Y. S. 2d 372 (1946). In that case the court held that the fact that the defendant New York corporation was controlled by the same copartnership as controlled a Dutch corporation which had employed plaintiff, did not make the New York corporation liable for the salary of the plaintiff. The court refused to disregard the corporate entity even though there were more extenuating circumstances than in the instant case, such as the facts that plaintiff worked for a good part of the employment period in question in the office of the defendant in New York, and that defendant paid his salary during part of that time. The court did allow plaintiff to state two causes of action against defendant corporation, based on sections of the Debtor and Creditor Law of New York not relevant to this case.

"On the basis of the foregoing cases, the findings of the Referee, even if accepted, would not justify the Referee's conclusion under the New York law and the allowance of the claims of the employees of Danin, Inc. would not be justified. Considered in the light of the findings which the Referee did not make, but should have made in accordance with Judge Hulbert's decision, the conclusion of the Referee is clearly erroneous."

Danin, Inc. and Belt Modes, Inc. were both what is generally known as "close" corporations. Rubin was the sole

stockholder and Board of Directors of both. Such one man corporations are not unusual in small business enterprises. They are used to limit personal liability. Naturally such corporations are completely controlled by the individual stockholder. That in itself, however, is not sufficient grounds for denying the stockholder the protection of the corporate entity. *Wormser, Disregard of the Corporate Fiction,* p. 83.

Rubin used his control of both corporations in the "normal and usual manner" of a one-man close corporation and not "as an instrumentality of wrong and injustice." Therefore the corporate entities should not have been ignored.

POINT III

The corporate entity should not be disregarded when the rights of innocent creditors have intervened as in the present case.

The rule for disregarding the corporate entity as set forth above has been applied only where the stockholders were to be held liable for their actions behind the corporate cloak. It has never been applied to hold liable some innocent third party.

The Courts have held that where the rights of creditors would be affected thereby the general rule for disregarding the corporate entity would not apply. *Darling Stores Corporation* v. *Young Realty Company,* 121 Fed. (2d) 112, and *Rapid Transit Subway Construction Company* v. *The City of New York,* 259 N. Y. 472, 491.

In the case of *Darling Stores Corporation* v. *Young Realty Company, supra,* the Court stated the rule as follows:

> "The courts will look through the form to get at the real intent of the association of individuals or cor-

> porations forming the organization, and, *if rights of third parties have not intervened,* will give effect to the real purpose of the organization in order to promote square dealing and effectuate justice." (Emphasis supplied.)

In *Rapid Transit Subway Construction Co.* v. *City of New York,* 259 N. Y. 472, 491, the Court stated:

> "In such case the Courts should disregard judicial forms and treat corporation and sole stockholder as a unit, in order that unjust enrichment at the expense of a third party may be avoided. *A different solution of the problem might be required if the rights of* minority stockholders or *creditors were affected.* That we do not decide now." (Emphasis supplied.)

It would appear from the above that if Belt Modes had been the sole stockholder of Danin, and not Rubin, once Belt Modes became insolvent and the rights of innocent creditors intervened, the Courts would not pierce the corporate veil. In the case at bar the situation is stronger because Belt Modes owned no stock in Danin.

The case at bar is the only case where a Court pierced the corporate veil to hold liable innocent creditors of a corporation which owned no stock in the other, merely because both corporations had a common stockholder.

It is respectfully submitted that, in the case at bar, if the Court found that the corporate entities should be ignored, then Rubin, as the sole stockholder both of Danin and of Belt Modes, should have been charged with the liability to the claimants, and not the Bankrupt. There was no justification for saddling the creditors of the Bankrupt with Danin's liabilities and relieving Danin and Rubin thereof.

If the corporate entity of Danin were to be ignored, then it would appear that for the same reasons the corporate entity of Belt Modes should also have been ignored, and thus Rubin should have been held liable to the creditors of both corporations. There appears to be no justification for ignoring the corporate entity only of Danin and not of Belt Modes since both were treated by Rubin in the same manner.

POINT IV

Before the claimants should have been permitted to go beyond the corporate entity of Danin they should have shown that they had exhausted their legal remedies against it.

It has been held that:

> "A simple contract creditor may not maintain an action to attack or set aside a transfer as fraudulent and in derogation of creditors' rights. *Carson* v. *Long-Bell Lumber Corp.*, 73 F. (2d) 397." *Commerce Trust Co.* v. *Woodbury, supra,* at page 488.

In the *Carson* case, *supra,* at page 402, the Court stated that:

> "It is elementary that a simple contract creditor, without having reduced his claim to judgment, and without having exhausted his remedy at law, or having acquired some lien upon the property transferred, cannot maintain a suit to set aside such transfer" (cases therein cited).

In the cases just above quoted, the situation was even stronger than in the case at bar, because creditors were

seeking to trace the assets of a debtor-subsidiary corporation in the possession of a parent corporation. In the case at bar, there is no evidence that Belt Modes was in possession of assets belonging to Danin.

The New York State statutes are indicative of the common law with reference to a situation where wage earners have not been paid. Section 71 of the New York Stock Corporation Law provides:

> "The stockholders of every stock corporation shall jointly and severally be personally liable for all debts due and owing to any of its laborers, servants or employees other than contractors, for services performed by them for such corporation. Before such laborer, servant or employee shall charge such stockholder for such services, he shall give him notice in writing, within thirty days after the termination of such services, that he intends to hold him liable. An action therefor shall be commenced within thirty days after the return of an execution unsatisfied against the corporation upon a judgment recovered against it for such services."

This statute is based on good common sense. If the claimants herein could have recovered from Danin, there does not seem to be any reason why the Courts should permit them to recover from anyone else; and if they could not recover from Danin, then their remedy was against Rubin. In the case at bar, we have the anomalous situation where simple contract creditors of one corporation seek to share in the assets of another without even: (1) Attempting to show any unjustifiable transfer of assets from one to the other, or, (2) Suing to set aside any such transfer, or, (3) Exhausting their remedies against their own debtor corporation, or its stockholders.

POINT V

When ignoring the corporate entity of Danin, Rubin, its sole stockholder, should have been held liable for its corporate obligations and not the creditors of the Bankrupt.

No cases have been found, except in the case at bar, where anyone, other than the stockholders responsible for the illegal use of a corporate entity, was held liable to third parties. The creditors of Belt Modes had nothing to do with the formation of Danin, were not even aware of its existence, and could not possibly be responsible for the non-payment of Danin's employees.

POINT VI

The ends of justice and of equity would be served only if Danin or Rubin were held liable for Danin's obligations to its employees. It would be unjust and inequitable to hold creditors of Belt Modes liable therefor.

As stated by the Court in the case of *Rapid Transit Subway Construction Co.* v. *The City of New York, supra*:

> "Here we are limited 'to the tests of honesty and justice' and no rigid yard stick has ever been fashioned which will measure honesty and justice."

In the view of the Trustee, simple fairness requires that either Danin or Rubin pay the wages due. The said employees, in concert with Rubin, by filing their claims against the Bankrupt, are making an attempt to mulct the estate of the Bankrupt for their benefit. In fact, there is not even any proof that Danin did not pay them.

This type of chicanery should not be permitted. The employees were hired by and worked for Danin, with their full knowledge and consent since they signed a union contract with Danin. There is no doubt that Rubin would prefer the estate pay these claims, so as to terminate his liability to his employees. As between the creditors of Belt Modes, who took no part in the arrangements and machinations between the two corporations, and Rubin, who organized the set-up, and the employees who acquiesced in the same, certainly Rubin should be held liable.

In the case at bar, the creditors are being defrauded by the allowance of these priority wage claims. Both the Bankrupt and Danin issued separate financial statements. The Bankrupt at no time represented that it was or might be liable for the obligations of Danin. Upon the strength of these statements and representations the Bankrupt's creditors sold merchandise to it. There was absolutely no way of knowing that the Bankrupt's assets were subject to the obligations of Danin, and there was no way of protecting themselves against this liability. Not only are the wage claims involved, but all other claims will now be allowed. For if the Court of Appeals' decision is upheld, Danin's tax claims and general claims would also have to be paid out of the estate of Belt Modes.

The claimants have not alleged that any fraud was perpetrated upon them. They do not seek equitable relief. Their claim is solely in law, to wit: That they rendered work for the Bankrupt. Upon the facts that is clearly not so. They rendered work for Danin, and not for the Bankrupt.

As the Court stated in the case of *In re Children's Aid Society,* 60 N. Y. S. (2d) 41 (1946):

> "The corporate entity may not be disregarded merely because it would be the more equitable thing to do in a private litigation."

In the case at bar, to make the creditors of the Bankrupt pay Danin's wage obligations is not even the more equitable thing to do. The Court of Appeals decision clearly results in an injustice to said creditors.

POINT VII

An agreement making a manufacturer responsible for the payment of wages by a contractor does not entitle the employees of the contractor to priority in the bankruptcy of the manufacturer.

The Court of Appeals attempted to spell out an agreement making Belt Modes responsible for the payment of wages by Danin, its contractor. The Trustee denies that there ever was such an agreement. However even if there were such an agreement, it would not entitle Danin's employees to priority in the bankruptcy of Belt Modes. See *In re Ageloff*, 40 Fed. Supp. 369 and Section 64a (2) of the *Bankruptcy Act* (*United States Code*, Title 11, Chap. 7, Sec. 104a (2)).*

J

Should Federal or State Law Govern the Situation at Bar?

Hon. Learned Hand, Chief Justice of the Court of Appeals for the Second Circuit has indicated that he was in doubt as to whether Federal or State Law should be applied to the problems of law involved and if Federal Law were to be applied, in what manner it was to be done (R. 148). The Court stated:

"Since the issue arises in bankruptcy there is some doubt about what law we should look to for its answer:

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* See footnote, page 14 *supra*, for text.

the law of New York where all the transactions occurred, or a 'federal common-law,' to be ascertained upon the model of *Swift* v. *Tyson,* 12 Pet. 1. There are expressions in recent decisions of the Supreme Court,* which at least when taken out of the context, hold that a bankruptcy court in deciding whether claims against the estate shall be allowed, will not limit itself to their validity judged by the law where they arose. It is not clear whether this goes further than to hold that the bankruptcy court need not give the same effect in distribution to a claim, valid under state law, which that law would give in insolvency—as the concurrent opinion in *Vanston Bondholders Protective Committee* v. *Green, supra,* declared—; or whether it means that the bankruptcy court may, and at times must, hold that claims provable against the estate have arisen from transactions out of which the state law would not have raised any claims whatever. Apparently, the Third Circuit has read the decisions in the second sense,** and we should have to choose here, provided that the law of New York and the 'federal common-law' differed, because the question is whether the transactions created any claims whatever against the bankrupt. We are satisfied, however, that there is no difference between the two laws in this respect."

It is respectfully submitted that it is important for the efficient administration of the bankruptcy law that the answer to this dilemma be supplied by the Supreme Court.

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* *Prudence Realization Company* v. *Geist,* 316 U. S. 89, 95; *Heiser* v. *Woodruff,* 327 U. S. 726, 731, 732; *Vanston Bondholders Protective Committee* v. *Green,* 329 U. S. 156, 162, 163.

** *In re Pittsburgh Railways Co.,* 155 Fed. (2) 477.

CONCLUSION

This case is one of general public interest concerning a fact pattern which frequently and regularly occurs in the use of the corporate entity by small business men. Where one person is the sole stockholder of more than one corporation, may the corporate entities be ignored? If so, may the liabilities of one corporation be shifted to any of the others? May it be shifted to the stockholder as well? May the contracts of one corporation be held to be the contracts of any of the others? Under what circumstances may either of these events occur? These are but some of the questions involved in this appeal.

There is also involved the very important question as to what should be done when the rights of innocent creditors have intervened. This question comes up for decision now for the first time.

Collateral questions, also important are (1) whether an Appellate Court can find a new set of facts not found in the Court below and (2) whether State or Federal common law should be applied in determining the allowance of claims in bankruptcy proceedings and if so, in what manner.

The determination of the questions involved in this case should clear up many ambiguities in the law involving the use of the corporate entity.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari be issued as of and under the seal of this Honorable Court directed to the United States Court of Appeals for the Second Circuit that a review of the case herein be made by this Honorable Court and that the opinion, decision and judgment of the Court of Appeals for the Second Circuit be in all things reversed and for such other relief in the premises as to this Honorable Court may seem just, equitable and proper.

Respectfully submitted,

ALLEN MURRAY MYERS
Attorney for Petitioner

MAY 23

Supreme Court of the United States

TERM, 1951

No. 694

In the Matter of

BELT MODES, INC.,

Bankrupt.

WILLIAM J. HENRY, Trustee in Bankruptcy,

Petitioner,

against

HELEN HOLLANDER, HARRY SHIMOFF, ROSE RENO, MORRIS DRABNER, EVA YUTKOFSKY, DAVID WISOTSKY, MILDRED L. FRANCES, DOROTHY QUITTNER, THELMA LOPEZ, SAM WEINBERG, GLORIA ANNIE JOSEPH, SAM SIEGAL, LEO KNAPHEIS and MAX KANER,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Opinions Below

The opinion of the Court of Appeals (146-151) * is not yet reported. The opinion of Judge Hulbert in the District Court (84-86) is not reported. The opinion of Judge I. R. Kaufman in the District Court (133-141) is reported at 88 F. Supp. 141.

* All references unless otherwise noted are to pages of the record on appeal.

Statement

Petitioner seeks a writ of certiorari to review a judgment (152) of the United States Court of Appeals for the Second Circuit which reversed an order (5-6) of the United States District Court for the Southern District of New York, sitting as a court of bankruptcy, which, in turn, reversed an order (126-127) of Hon. John E. Joyce, Referee in Bankruptcy, which allowed the claims of the respondents against the estate of the bankrupt.

The Parties

The bankrupt, Belt Modes, Inc., is a corporation, formerly engaged in the manufacture and sale of belts and pocketbooks (20-21), the stock of which was wholly owned by its President (60-61), one Daniel Rubin (12), who was also its sole director (73).

The respondents are 14 pocketbook workers who were nominally employed by Danin, Inc., a corporation formerly engaged in the manufacture of pocketbooks (20-21), the stock of which was wholly owned by the same Daniel Rubin (12), who was also its President (60-61) and its sole director (73).

The petitioner is the Trustee in Bankruptcy of Belt Modes, Inc.

The Matter at Issue

The matter at issue is whether the claims filed by respondents against the estate of the bankrupt shall be allowed. The amounts of the claims have been stipulated and are not in dispute (81, 128). They vary, for the various claimants, from about $20 to about $180 and aggregate about $995 (81, 128).

The Proceedings Below

The claims here in question are for wages owing to respondents. At the time Belt Modes went into bankruptcy, Danin, which was respondents' formal employer, was entirely without assets (37, 91, 107). Respondents' position is that they are entitled to recover their wages from the estate of Belt Modes because Danin, despite its *prima facie* separate corporate existence, was a mere agent and instrumentality of Belt Modes, which, accordingly, was respondents' real employer.

Respondents' position was sustained by the Official Referee who in his findings (123-125) found as a matter of fact, among other things, that Danin "was merely a department or division of the enterprise conducted by the bankrupt under the control of Rubin and was not intended or conducted as a corporation engaged in business for profit" and that "the claimants were in truth, in fact and in reality employees of the bankrupt" (125).

Accordingly, the Referee allowed respondents' claims (126-127).

The District Court, however, reversed the Referee's order, on the grounds that the Referee's findings were not sustained by the evidence (139) and that the separate corporate entities of Danin and Belt Modes could not be disregarded because they had not been established for a fraudulent purpose (139-141).

Upon appeal, the Court of Appeals unanimously reversed the decision of the District Court and directed that respondents' claims be allowed. The Court, in an opinion by Judge Learned Hand, sustained the Referee's findings of fact (146-147) and went on to hold that Rubin, the sole stockholder, director and officer of both corporations, had agreed on behalf of Belt Modes that Belt Modes as well as Danin should be liable for the payment of respondents' wages (149-151).

Questions Presented

The only questions presented upon this petition are questions of fact as to which both the Official Referee and the Court of Appeals found in favor of the respondents. These questions are:

1. Whether the Referee's findings are sustained by the evidence.

2. Whether Danin, despite its *prima facie* separate corporate existence, was nothing but a department and instrumentality of Belt Modes so that respondents, although formally employed by Danin, were in reality employed by Belt Modes.

3. Whether Rubin, the sole stockholder, director and officer of both corporations, agreed on behalf of Belt Modes that Belt Modes would be liable for respondents' wages.

The Facts

For some time prior to 1946 Belt Modes, whose business was the manufacture and sale of ladies' belts (14-15), operated under a collective bargaining agreement with the Belt Makers Union (12, 14, 15). In 1946, however, it undertook the manufacture of children's and misses' handbags, and, shortly thereafter, the Pocketbook Workers Union of New York demanded that it be recognized as the representative of Belt Modes' employees (14-15).

In an effort to avoid a jurisdictional dispute between the two unions, the attorney for Belt Modes suggested to Mr. Rubin that employees working on pocketbooks be segregated from those working on belts and that two separate collective bargaining agreements be entered into, with each union representing the employees within its jurisdiction (14, 15, 24). To implement this plan, the attorney suggested that a new corporation be organized to take

over the pocketbook work and to enter into a collective bargaining agreement with the Pocketbook Workers Union (14-15, 24).

Accordingly, Danin was organized to manufacture pocketbooks [1] (14-15) with Mr. Rubin as president and sole stockholder (12, 60-61).

Under the new arrangement the Belt Makers Union continued to represent the production employees of Belt Modes (12) while the Pocketbook Union represented the employees of Danin (12, 24).

In the course of the negotiations leading to the execution of the collective agreement between Danin and the Pocketbook Workers Union, Rubin asked Gallack, the business agent for the union, whether he would object if "a different shop" were opened. Gallack answered, "No, we will not object, if you are the same owners and hold all the contracts and the benefits as it is". Again, when Rubin told him that he was organizing Danin, Gallack said, "We have nothing to do with the new Company. Our benefits are the same, Belt Modes". To this Rubin replied, "It is the same. Just for legal * * *. This has nothing to do with the union" (98). And on cross-examination Gallack said, "We had the contracts straight along with Belt Modes". "Everything the same as before; just to put down the name Danin, for legal purposes" (100). There was also an agreement made between Danin and Belt Modes (63-74, esp. 74) by which it was agreed "that Belt Modes would pay all of the employees of Danin such moneys that were to be expended or had to be expended in the course of their employment" (74).

The Belt Modes office and place of business was at 1 East 33rd Street, New York City (hereinafter referred to as the "uptown premises") (15). For about a year after Danin was organized, separate premises were leased in its name at 396 Broadway (hereinafter referred to as the "downtown premises") and the pocketbooks there manu-

[1] Occasionally Danin did work on belts (105).

factured (15-16). When financial conditions made the maintenance of two establishments impracticable, the Danin operation was moved back to the uptown premises (16); and employees making belts worked side by side with those making pocketbooks (20-21, 24), although each was still covered by a different collective bargaining agreement (24). The wages here involved were all earned during the period after this change had been made (148).

The machinery used at the downtown premises, which constituted Danin's sole capital assets (25-26, 91), had been taken in part from Belt Modes' premises uptown and in part had been bought by Mr. Rubin with money taken from his account with Belt Modes (25-26). When the downtown establishment was given up, some of the machinery was returned to Belt Modes' premises uptown; the rest was sold and the proceeds either given to Belt Modes or credited to Mr. Rubin's account with Belt Modes (25-26).

It never became necessary for Danin to maintain an office staff (64-65), as the office workers of Belt Modes always did the office work for both corporations (27). Danin's books were physically at the Belt Modes' office (32)[2]; where its payroll was made up (111) by the Belt Modes bookkeeper (24, 32), who kept the books of both corporations (24, 32).

Danin's activities were confined entirely to the production of children's and young misses' handbags for Belt Modes (12, 16), its only customer (16, 23, 93). Belt Modes furnished all materials on which Danin worked (16, 23), and paid all Danin's operating expenses (24-25, 26, 32, 93).

No pretense at arm's length dealing between Danin and Belt Modes was ever made. Finished goods sent by Danin to Belt Modes were not billed on the basis of any fixed

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[2] The only books maintained for Danin were a payroll book, a general ledger, a general journal, and possibly a sales ledger. Belt Modes, in addition to the foregoing, kept a cash receipts book, a cash disbursements book, a purchase book, a sales return book, a customers ledger, and a creditors ledger (22).

unit price. The bills were used simply to cover advances and estimated advances made by Belt Modes to Danin for the payment of Danin's creditors—its landlord, its employees, and certain insurers[3] (32, 34, 39, 40, 43, 44, 95)—so that the books of Belt Modes could be kept in balance (32, 34, 39, 40, 43, 44, 95). The bills themselves were made out by the Belt Modes bookkeeper (34, 110).

Unit prices were determined simply by dividing the moneys advanced by Belt Modes to Danin ratably over the goods that Danin worked on for Belt Modes (39, 40, 43). Often particular goods sent by Danin to Belt Modes were not billed at all, with the result that the bills for other goods had to be adjusted upward so as to cover the total advances made (44). Of course, in its dealings with sub-contractors other than Danin, Belt Modes entered into contracts at a fixed unit price (61). The contract between Belt Modes and Danin, however, contained no unit cost figure; Belt Modes simply agreed to pay Danin's costs of operation (74).

Thus, in the case of Danin's payroll the Belt Modes bookkeeper would compute the payroll each week for the employees of both corporations, divide the total payroll into two parts, one for the belt makers and one for the pocketbook workers, and place to Danin's credit in its bank account a sum sufficient to cover the pocketbook payroll. The bookkeeper would then draw a check on the Danin account for the cash payroll (24-25, 26). Sometimes Danin was by-passed entirely, the cash payroll check for the Danin employees drawn directly on the Belt Modes bank account, and Belt Modes credited with the payment on the books of Danin (47).

The wage claimants, although carried on the payroll of Danin, were always treated as the employees of Belt Modes.

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[3] Danin carried compensation, liability and payroll insurance. It did so as a precautionary measure to avoid the possibility of a claim by an insurance company that insurance taken out in the name of Belt Modes did not cover employees and payroll that were nominally Danin's (89-90).

Indeed, some at least were under the impression that such was the case (104). Employees of Belt Modes who upon the organization of Danin were sent to work at the downtown premises were never told of any change of employment (98, 112). And even when the two companies occupied separate premises, belt workers from Belt Modes were occasionally sent downtown to Danin, and on many occasions pocketbook workers from Danin were sent to work at the uptown premises of Belt Modes (105, 119, 122).

All new employees were first interviewed by Belt Modes at the uptown premises (101-102). When employees of Danin who had been laid off were directed to report back to work, they received a card signed by Belt Modes which told them to report to Mrs. Munzer, the manager employed by Belt Modes (114, 120, 98); and they reported to her at the uptown premises occupied by Belt Modes (114). Mr. Rubin had ultimate supervision over the production employees of both Danin and Belt Modes (61), while Mrs. Munzer, an employee of Belt Modes, was in immediate charge of the Danin production workers in the downtown premises (62, 64-65). Even when Danin occupied the downtown premises, union grievances relating to the employees of Danin were taken up with Mrs. Munzer at the uptown premises (98).

POINT I

The evidence conclusively establishes that Danin was merely a department and instrumentality of Belt Modes and, accordingly, the separate entities of the two corporations must be disregarded and the respondents' claims allowed.

There is literally no evidence in the record to controvert the facts set forth in the statement of facts in this brief; and those facts make it undisputably clear that Danin was conducted simply as a department and instru-

mentality of Belt Modes and not as an independent enterprise engaged in business for profit.[4]

This ultimate fact, as well as the evidentiary facts which establish it, were specifically found by the Official Referee (77-79, 123-125).

And the Referee's findings were affirmed by the Court of Appeals (146-151, esp. 146-148).

The law is well settled that where one corporation is the wholly-dominated subsidiary and instrumentality of another the separate entities of the two corporations will be disregarded when necessary in the interests of justice and for the protection of the rights of third parties.

> "The so-called instrumentality rule, * * * is not, properly speaking, a rule, but a convenient way of designating the application, in particular circumstances, of the broader equitable principle that the doctrine of corporate entity, recognized generally and for most purposes, will not be regarded when so to do would work fraud or injustice."
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> *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, 322 (1938).

This principle has found specific application in cases where the factual identity between two legally distinct corporations has been recognized and the corporate veil pierced in order to permit the creditors of one corporation to share in the assets of the other.

> *Stone* v. *Eacho*, 127 F. (2d) 284 (C. A. 4th, 1942), cert. den. 317 U. S. 635;
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> *Commerce Trust* v. *Woodbury*, 77 F. (2d) 478 (C. A. 5th, 1935), cert. den. 296 U. S. 614.

See also:

> *Hunter* v. *Baker Motor Vehicle Co.*, 238 Fed. 894 (C. A. 2nd, 1916);

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[4] See, e.g., *Fish* v. *East*, 114 F. (2d) 177, 191 (C. A. 10th, 1940); *Commerce Trust Co.* v. *Woodbury*, 77 F. (2d) 478, 487 (C. A. 5th, 1935), cert. den. 296 U. S. 614.

Roof v. *Conway,* 133 F. (2d) 819, 823-824 (C. A. 6th, 1943);

Darling Stores Corporation v. *Young Realty Co.,* 121 F. (2d) 112, 115 (C. A. 8th, 1941), cert. den. 314 U. S. 658;

Kimberly Coal Company v. *Douglas,* 45 F. (2d) 25, 27 (C. A. 6th, 1930).

POINT II

The evidence conclusively establishes that Rubin, the sole stockholder, officer and director of both corporations, agreed on behalf of Belt Modes that Belt Modes would be liable for respondents' wages.

The facts are clear that, at the time the wages here involved were earned, and at the time of the bankruptcy of Belt Modes, Danin had no assets.

(a) Samuel Arthur, one of the accountants for both corporations, testified as follows (at p. 91 of the record):

> "Danin itself, after they were on the same premises with Belt Modes, never had any assets. All it had was a revolving cash account, which was replenished by Belt Modes from time to time to give it the funds to meet these payrolls."

(b) William S. Brown, the Receiver in Bankruptcy appointed in this case, testified as follows (at p. 37 of the record):

> "Q. When you took over the premises of Belt Modes did you check whether anything belonged to Danin, Inc.? A. With respect to property?
>
> Q. Anything there at all; property, books or anything that was there. A. Well, there was no property that I know of that belonged to Danin. We found some records that belonged to Danin."

(c) Sol Pitkin, who had been employed as a foreman by Belt Modes, testified as follows on cross-examination by the attorney for the Trustee (at p. 107 of the record):

> "Q. You recovered a judgment against Danin, Inc., didn't you? A. Yes.
> Q. You could not collect that judgment, could you? Did you collect it? A. No."

The Court of Appeals specifically found that Danin was without assets of any kind when these wage claims arose and when Belt Modes went into bankruptcy. The Court said (147-148):

> "Early in 1948 Rubin * * * closed up the Broadway factory. He sold some of the machinery, moved back the rest, and resumed making both belts and pocketbooks at 33rd Street. The bookkeeping continued as before, *but Danin, Inc. had no longer property of any kind.* All the wage claims here in suit arose after this change had been made." (Italics supplied.)

The Court of Appeals went on to point out that under these circumstances it must be presumed that Rubin, who was the sole person authorized to act on behalf of both Belt Modes and Danin, intended to make Belt Modes as well as Danin liable for the payment of respondents' wages. For it would have been a fraud on respondents to require them, for the payment of their wages, to look to Danin alone—a corporation entirely without assets. The Court of Appeals declared (149-150):

> "As we have suggested, it is possible, and we shall indeed assume, that Danin, Inc., became liable to the claimants for their wages; but that does not end the inquiry, because Rubin might have intended also to make the bankrupt liable. In fact he must have so intended, because not to do so would have left the claimants with an employer destitute, or substantially destitute, of any power to perform its engagement; and plainly that would have been a fraud on them.

> Even while the work was being done on Broadway, Danin, Inc., had no assets except its machinery, and during the period when the wages in suit were being earned—i.e., after the Broadway factory had been abandoned—it had no assets at all and was wholly dependent upon the bankrupt. It would be most unfair and unreasonable to impute to Rubin so dishonest an intention, especially when we remember that the result might well have been to expose him to a heavy fine."

Furthermore, as we have pointed out in our statement of the facts, there was an express agreement between Rubin and Gallack, the business agent of the Pocketbook Workers Union, that Belt Modes would be liable for respondents' compensation; and the Court of Appeals so found, saying (150-151):

> "Furthermore, when we consider the negotiations between Gallack and Rubin that preceded the execution of the contract, this conclusion is confirmed. Gallack, being as we have said the 'bargaining agent' of the union, was the agent for the claimants individually; the negotiations make it clear that he and Rubin did not intend the contract to be the measure of the claimants' remedies. Thus, when Rubin (fol. 152) asked Gallack whether he would object if 'a different shop' were opened, Gallack answered: 'No, we will not object, if you are the same owners and hold all the contracts and the benefits as it is.' Again, when Rubin told him that he was organizing Danin, Inc., he said: 'We have nothing to do with the new company. Our benefits are the same, Belt-Modes'; to which Rubin replied: 'It is the same. Just legal. * * * This has nothing to do with the union.' Finally, on cross-examination: 'We had the contract straight along with Belt-Modes.' 'Everything the same as before; just to put down the name Danin for legal purposes.' That Rubin also understood the matter in the same way appears from the testimony of Pitkin, one of the foremen in the Broadway factory. When he asked Rubin why the contract was with Danin, Inc., Rubin answered that he should not 'worry about

it, because' he was 'working for Belt-Modes regardless of the agreement.' We do not doubt this testimony; we should have to believe that the employees, who for the most part had been theretofore working for the bankrupt, were willing to accept as a substitute a new employer of which they knew nothing and whose existence did not in any important sense change the former conduct of the business; and, indeed, during the period in question did not change it at all."

In addition to the foregoing, the record clearly establishes an agreement between Danin and Belt Modes that Belt Modes would pay the respondents' wages. This was a written agreement (63). However, the agreement was lost and could not be produced upon the hearing before the Referee (63-74). Accordingly, Mr. Harston, the attorney who drew the agreement, was permitted to testify as to its contents (67-74). He testified, and his testimony was uncontradicted, that the agreement provided as follows (74):

"That an amount was to be computed at different times, predicated on the payroll of Danin to the extent that Belt Modes would pay all of the employees of Danin such moneys that were to be expended or had to be expended in the course of their employment; to make whatever deductions had to be made from such amounts for tax purposes."

It is thus perfectly clear that Belt Modes agreed to be liable for the payment of respondents' compensation. Therefore, entirely aside from the reasons advanced in Point I of this brief, respondents' claim must be allowed.

POINT III

Petitioner's entire case is based on the contention that this Court should review questions of fact which have been fully considered and passed upon by the Official Referee and the Court of Appeals.

Petitioner contends:

1. That Danin was an independent business and was not a mere department and instrumentality of Belt Modes; and that, therefore, the entities of the two corporations may not be disregarded.

2. That Danin had assets at the time of the Belt Modes bankruptcy; and that, therefore, respondents should have proceeded against Danin.

3. That Danin was incorporated prior to the incorporation of Belt Modes; and that, therefore, Belt Modes could not have agreed to be liable for respondents' wages.

The difficulty of these contentions is that each of them is predicated upon an assumption of fact squarely in conflict with the facts found by the Official Referee and the Court of Appeals.

In this connection it should be observed that the Referee's findings of fact must be sustained unless clearly erroneous. General Order 47, promulgated by this Court pursuant to authority granted by Section 53 of the Bankruptcy Act (11 U. S. C. Sec. 33) provides:

> "Unless otherwise directed in the order of reference the report of a Referee or a Special Master shall set forth his findings of fact and conclusions of law *and the judge shall accept his findings of fact unless clearly erroneous.*" (Italics supplied.)

(a) As we have shown in Point I above, both the Official Referee and the Court of Appeals found that Danin was

merely a department and instrumentality of Belt Modes and was not conducted as an independent corporation engaged in business for profit (see supra, p. 9).

(b) The Court of Appeals clearly found—and its finding is supported by the uncontradicted evidence in the record—that Danin was entirely without assets at the time the wage claims here in issue arose and at the time that Belt Modes went into bankruptcy (see supra, p. 11).

(c) The Official Referee specifically found that Belt Modes was incorporated prior to the incorporation of Danin (77, 123). The Court of Appeals made the same finding (146-147). There is no evidence in the record to contradict this finding. Petitioner claims (164) that the minute book of Belt Modes shows that Belt Modes was incorporated at a later date than Danin. But the minute book of Belt Modes is not part of the record in this case (see stipulation as to exhibits at pp. 142-143 of the record).

Even if petitioner were correct in its claim that Danin was incorporated prior to the incorporation of Belt Modes, there would still be no merit to its argument that Belt Modes, therefore, could not have agreed to be liable for the payment of respondents' wages. The date of incorporation of Belt Modes is of no significance, as the business in which the corporation engaged was the identical business which had theretofore been conducted by Rubin under the trade-name of Belt Modes. Any obligation to pay respondents' wages undertaken by Belt Modes before its incorporation would therefore be equally binding upon Belt Modes, Inc.

(d) There is no merit whatever to petitioner's claim that the exhibits which were not made a part of the printed record were not considered by the Courts below. Petitioner himself does not contend that they were not considered by the Official Referee, and petitioner's petition for rehearing in the Court of Appeals (153-167) conclusively establishes that those exhibits were brought to the atten-

tion of the Court of Appeals in connection with that petition. It must be presumed that in denying the petition for rehearing the Court of Appeals considered those exhibits and decided that they did not warrant a reconsideration of the case.

CONCLUSION

Petitioner has given considerable emphasis to the argument that the allowance of respondents' claims would constitute a fraud upon the other creditors of Belt Modes. This argument is without merit.

It is perfectly clear that the other creditors of Belt Modes did not deal with that corporation in reliance on the fact that its pocketbook-making operations were carried on by a separate corporate entity. Indeed, those pocketbook-making operations were originally carried on by Belt Modes itself, and the record is barren of any evidence that the creditors of Belt Modes had any knowledge of the change that occurred when Danin was organized. As the Court of Appeals declared (151):

> "Nor was there * * * the slightest injustice to the bankrupt's other creditors, as the Trustee suggests. During the period in question—after the pocketbook business had been moved back to 33rd Street—there was nothing to indicate that it was being carried on separately from the belt business. No creditor has appeared to say that he gave credit to the bankrupt in reliance upon the apparent separation of the business while the Broadway factory was in operation; and we need not say whether upon such proof he would establish a priority over the claimants. As the evidence stands, the bankrupt's creditors took their chances of its credit as unsecured creditors always do; this was not the case of a secret lien upon property pledged or sold to another."

The fact of the matter is that, far from the allowance of respondents' claims constituting a fraud upon the other

creditors of Belt Modes, the disallowance of respondents' claims would constitute a fraud upon respondents. For, as the Court of Appeals pointed out (149), Danin was "an employer destitute, or substantially destitute, of any power to perform its engagement"; and to hold that respondents could proceed only against Danin would clearly implement the perpetration of "a fraud on them".

For these reasons, and for all of the other reasons hereinabove set forth, it is respectfully submitted that the petition for a writ of certiorari herein should be denied.

Respectfully submitted,

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